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Transition Series

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The Budget Deficit

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United States
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Comptroller General
of the United States

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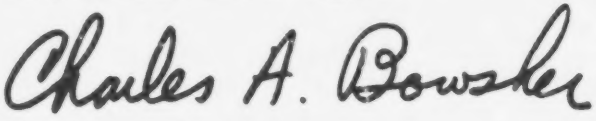
The President of the Senate
The Speaker of the House of Representatives
The President-elect of the United States

One of the most important issues the new President and Congress need to address is reducing the deficit. If we do not get better control over the deficit, it will be exceedingly difficult to implement any new initiatives to deal with the array of needs in the country—be they more money for AIDS research, more money to assure that we have a good air safety system, or more money for needed weapons systems for our armed services.

This report presents an approach for addressing the deficit. Other reports in the transition series discuss specific issues affecting the largest government agencies. They are identified in the back of this report. All of GAO's reports in this transition series are based primarily on detailed reports and testimony already provided to Congress.



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Contents

Letter	1
Resolve the Budget Deficit	4
Related GAO Products	17
Transition Series	18

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Resolve the Budget Deficit

Among the most urgent issues facing your new administration and the new Congress is the budget deficit. Unless this problem is solved—including finding ways to finance the growing list of unavoidable, but so far unfunded, costs—it will hamstring the administration's ability to achieve other vital policy goals; it will make it very difficult to begin addressing the Nation's unmet needs, and it could sap our long-run economic vitality.

There are no quick or painless solutions to the federal government's budget problem. The apparently simple or painless answers will not work.

- We cannot "grow" our way out of the problem. Public demand for government services—to solve problems ranging from drug abuse, AIDS, education, and homelessness to drought and forest fires—grows as fast as revenues, particularly with the potential for "natural" growth of revenues having been greatly reduced with the indexation of the tax code. Projections of a declining budget deficit have misled previous Presidents into believing that budget problems will solve themselves. That picture always evaporated with the passage of time.

- We cannot "freeze" our way out of the problem. Much of the budget is concentrated in politically sensitive entitlement programs, such as Social Security, Medicare, and farm price supports; in the defense program; or in interest costs, which flow directly from the deficit.

- We cannot "sequester" our way out of the problem through mechanistic, formula-based program cuts of the sort prescribed in the Gramm-Rudman-Hollings (GRH) legislation. With between 70 and 80 percent of the budget exempted for a variety of reasons, the rest of the government would be gutted if the machinery were allowed to operate without restraint. The unacceptability of this consequence was demonstrated in 1987, when Congress and the Reagan Administration deferred the GRH targets rather than permit an 8.5- to 10.5-percent sequester. Notwithstanding the rhetoric, the GRH approach has accomplished little more than constraining the growth of the deficit.

- And we cannot reach out and effortlessly gather in some magic pool of uncollected revenues. The results of a tax amnesty program are highly uncertain. Some states have had a favorable experience, but we are skeptical that an amnesty at the federal level would ever yield more than a

modest one-time bulge in revenues. More rigorous enforcement of the tax laws has some potential, and we strongly support those efforts, for reasons of fairness in the tax system as well as because of the revenue yield. But hiring and training the thousands of needed revenue agents will take several years. The administrative costs will be large before significant results are seen, and even then the revenue yield will be very modest compared to the problem.

The Situation Is Worse Than It Seems

To compound the difficulty, the budget problem is substantially worse than appears on the surface.

First, the reported deficit understates the real situation. In 1988, for example, the reported deficit of $155 billion actually consisted of a surplus of $97 billion in the trust funds and a deficit in the general funds of $252 billion. The Congressional Budget Office estimates that the general fund deficit will continue to grow, headed toward $300 billion in the early 1990s, but will be masked by the rapidly growing Social Security surpluses.

Second, there is an explosion of unfunded costs waiting to greet the new administration. Some of these are unavoidable.

- The Federal Savings and Loan Insurance Corporation (FSLIC), insurer of about $1 trillion of deposits in the Nation's thrift institutions, is insolvent. There are about 500 insolvent thrifts which are losing money at the rate of almost $17 billion per year. We estimate that it will cost at least another $50 billion to deal with FSLIC's problems, with a significant amount of the money coming from the federal taxpayer.

- The Department of Energy faces the task of cleaning up and modernizing its aging and environmentally hazardous nuclear weapons production complex, involving 50 facilities around the country, some of which have been in use for over 40 years. Serious safety problems that cannot be ignored exist at some facilities. Based on preliminary data, we estimate the cost, over a number of years, of cleanup and modernization at $100 to $130 billion.

- The Department of Defense (DOD) must clean up the hazardous waste pollution that has been identified at over 5,000 sites on military facilities across the Nation. Efforts are underway or planned at less than half these sites. DOD estimates the total program cost at $11 to $14 billion.

In addition, a number of programs are underway whose costs are rapidly escalating far beyond amounts included in the budget forecasts. This will force painful choices of which programs to terminate or curtail and how to finance those that are to be continued.

- The programs included in DOD's most recent 5-year plan will cost at least $200 billion more than is likely to be available even assuming that the defense budget grows 2 percent faster than inflation. There may not be enough money to buy and support all the new weapons systems that DOD has been developing.

- Development of the Strategic Defense Initiative is being funded in 1989 at about $4 billion. DOD has estimated that building the first phase of an operational system will cost $69 billion. Because of the many technical uncertainties, experience suggests that the actual cost will be substantially higher. Some estimates of the cost of a full system range up to $1 trillion or more.

- Several agencies are undertaking badly needed modernization of key computer and telecommunications systems, involving substantial capital investment and operating costs.

—The Internal Revenue Service's Tax System Redesign is expected to cost several billion dollars over the next 10 years.

—An Air Force satellite control system is estimated to cost $48 billion from 1990 to 2015.

—FTS-2000, replacing the government's long distance telephone service, is estimated to cost up to $25 billion over the next 10 years.

—The Department of Veterans Affairs and the Social Security Administration will spend about $1 billion each to modernize key computer systems.

—The Air Force will spend $1.5 to $2 billion to modernize the antiquated computers used to manage over 900,000 items in its supply system.

- The Federal Aviation Administration is 6 years into a program to modernize the Nation's air traffic control system. Originally projected to cost $12 billion, we now estimate the cost will reach $25 billion by the year 2000.

- The National Aeronautics and Space Administration is developing the space station. It will cost an estimated $28 billion

to build and $1.4 billion per year to operate.

There is also a long list of national problems for which there is growing public pressure that the federal government provide a solution.

- Proposals to assist the elderly in financing long-term health care have budgetary price tags ranging from $8 to more than $50 billion per year.

- Suggested tax incentives to encourage companies to fully fund the health care benefits they have promised their retirees could reduce tax revenues by $6 billion.

- The Department of Transportation estimates that it will cost about $50 billion to repair or replace the Nation's 240,000 deficient bridges and that another $315 billion will be needed through the year 2000 to maintain the highways in their 1983 condition. Costs for these items are shared by federal and state governments.

- A study sponsored by the Department of Housing and Urban Development estimates that it will cost about $20 billion to repair the deteriorating stock of public housing. Additional billions may be needed to prevent diversion to other uses of the stock of

privately owned, subsidized low-income housing. No one knows the cost of a serious effort to deal with the problem of up to 3 million homeless Americans.

- In responding to a recent GAO questionnaire, the managers of our National Parks reported a $1.9 billion backlog of deferred maintenance.

- The United States Sentencing Commission has estimated that the federal prison population will be between 78,000 and 125,000 in 10 years. It will cost between $2 and $4.6 billion to build the prisons needed to hold overcrowding to 20 percent above capacity.

Unless the problem of the budget is attacked promptly and aggressively, there will be little money with which to meet these needs or the countless others facing the Nation, ranging from the public health emergency of AIDS and day care for the children of working parents, to improved education, and the diverse environmental problems about which public concern is rising toward panic levels.

Solving the Problem

The budget problem must be solved for the new administration to have any flexibility to pursue its own policy agenda, for the economy to retain its vigor, and for the

American people to enjoy a long-term standard of living comparable to the rest of the developed world. And it can be solved, but not with magic potions, not with smoke and mirrors, not with the traditional techniques of incremental budgeting, and not by perpetuating the confrontations between executive and legislative branches that have typified recent years. The problem can only be solved by hard, good faith political bargaining between the President, the Cabinet, and the Congress.

The foundation for a realistic approach to solving the budget problem is recognition of the following:

1. Continuing budget deficits are a crisis; the crisis warrants the commitment and bipartisan spirit of compromise in the national interest that our political system traditionally brings to a crisis situation.

2. The problem cannot be solved by the President alone, nor by the Congress alone, but only through the combined efforts of both branches of government.

3. The problem cannot be solved in 1 year, but requires a carefully developed, politically sustainable, multiyear budget strategy.

With this foundation, the first step must be for the President to open negotiations with the bipartisan leadership of both houses of Congress in an effort to develop consensus on a meaningful budget strategy. For the negotiations to succeed, certain elements are key.

1. All participants must consider all parts of the budget to be negotiable, including defense, entitlements, and revenues.

2. The pace at which the deficit is to be reduced can be negotiable, but only within reasonable limits. The goal must be to reduce the deficits in the general fund and to move toward approximate balance or surplus in the unified budget at a steady, sustainable pace.

3. The agreement on strategy must be sufficiently specific to be meaningful, but flexible enough to allow for changing conditions. An appropriate goal would be an agreement structured along the lines of a congressional budget resolution and extending for 5 years.

4. The negotiations must work with realistic estimates of costs—including recognition of known budget threats—and with credible economic forecasts.

5. The Federal Reserve chairman should be asked to participate—at least as an observer—because of the importance for the economy of carefully adjusting monetary policy as progress is made on the deficit.

Achieving Consensus

Experience has demonstrated that in certain policy areas agreement on budget numbers will unravel quickly unless there is also agreement on how the numbers wil' be achieved.

1. In defense, it is already evident that the budget cannot finance all the weapons systems now being developed while also maintaining the present force structure with adequate readiness and sustainability. The Department of Defense's planning has not yet adjusted to the implications of this new reality, which will produce dangerous imbalances and inefficiencies unless carefully managed. These adjustments need to be accompanied by a thorough reexamination of our international commitments and our defense goals, strategies, and force structures.

2. In negotiating spending levels for entitlement programs, attention must be given to the implications for the trust funds. If cost-of-living adjustments are restrained, for example, the Social Security trust fund

surpluses will grow at an even more rapid pace. While this will help reduce the overall deficit, the negotiations must also address the sensitive issue of how these additional "reserves" will be used.

The reserves, of course, are only entries on the books at Treasury. When they are needed to pay benefits to retirees, the cash will have to come from tax revenues or more borrowing.

3. Additional revenues are probably an unavoidable part of any realistic strategy for reducing the deficit. In negotiating this element, it is essential that the agreement cover not just the amounts of revenue to be raised but also:

- the specific sources (income, payroll, consumption, or excise taxes, or specific user fees);
- the legislative schedule for enactment of the required statutory changes;
- a realistic schedule for implementing the new laws; and
- the administrative resources needed to collect the additional revenues.

Negotiating a strategic agreement on budget policy will be an arduous task. Substantial personal involvement by the President will be essential, both because of the stature he brings to the process and because of the need to make tradeoffs among competing political objectives of the administration.

The Nation is at a crossroads in dealing with the budget deficit. If the President and Congress promptly seize the initiative and successfully negotiate a new consensus on budget policy, they can put the Nation on the path to continued growth and to sustainable domestic and international financial relationships. If they procrastinate or fail, the Nation's economic future will be at risk and the administration's ability to achieve other policy objectives will be imperiled by a lack of resources and a continued atmosphere of confrontation with Congress.

Related GAO Products

Comptroller General's Letter to Drew Lewis and Robert Strauss, Co-Chairmen, National Economic Commission, (Aug. 3, 1988)

Improving Government Management and Accountability (GAO/T-AFMD-87-1, Feb. 18, 1987)

Budget Issues: Capital Budgeting for the Federal Government (GAO/AFMD-88-44, July 1988)

Budget Reform for the Federal Government (GAO/T-AFMD-88-13, June 7, 1988)

Managing the Cost of Government: Building an Effective Financial Management Structure (GAO/AFMD-85-35, Feb. 1985)

Defense Budget and Program Issues, Fiscal Year 1989 Budget (GAO/T-NSIAD-88-18, Mar. 14, 1988)

Nuclear Health and Safety: Dealing With Problems in the Nuclear Defense Complex Expected to Cost Over $100 Billion (GAO/RCED-88-197BR, July 6, 1988)

Deficit Reductions for Fiscal Year 1989: Compliance With the Balanced Budget and Emergency Deficit Control Act of 1985 (GAO/AFMD-89-32, Nov. 15, 1988)

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20